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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 695 - 696

BENTLY S. HANDWORK, RALPH C. BOOZER, AND PHILIP W. LOTZ, INDIVIDUALLY AND AS TRUSTEES, ETC.,
Petitioners,

vs.

HORACE A. YOUNG, AS TRUSTEE IN BANKRUPTCY OF THE ESTATE OF GEORGE R. JOSLYN, BANKRUPT,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioners, by their attorneys, respectfully petition this Honorable Court for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit to review the judgments of that Court entered in the above entitled cause on December 12, 1949, and in which a petition for rehearing was denied on February 10, 1950, and respectfully represent to this Court:

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

The ultimate question here is whether a federal court, having jurisdiction of a plenary action by a bankruptcy trustee against fiduciaries of a trust on the sole ground of an alleged diversity of citizenship must apply a statute of Illinois which has been interpreted by the highest court of that state to bar such an action.

This action was brought in the United States District Court for the Northern District of Illinois, Eastern Division, by the respondent, Horace A. Young, as Trustee in Bankruptcy of the Estate of George R. Joslyn, Bankrupt, against the petitioners, Bently S. Handwork, Ralph C. Boozer and Philip W. Lotz, individually and as Trustees, etc., to recover the interest of George R. Joslyn in trusts created by his father and mother, hereinafter called the "Joslyn Family Trusts" (R. 2-6).

The complaint alleged that the interest of the bankrupt in the Joslyn Family Trusts had passed to the respondent as trustee in bankruptcy under Section 70(a)(5) of the Bankruptcy Act (11 U. S. C. 110(a)(5)[1]) and that therefore the bankruptcy trustee was entitled to recover the bankrupt's trust interests from these petitioners as trustees (R. 2-7).

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1. (a) The trustee of the estate of a bankrupt * * * shall * * * be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy * * * except insofar as it is to property which is held to be exempt, to all * * * (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: * * *.

Petitioners urged, by motion to dismiss, that there was no diversity of citizenship and that Section 49 of the Illinois Chancery Act (Sec. 49 of Ch. 22, Ill. Rev. Stats.) barred the respondent from any recovery (R. 10-11, 181-182). Although all of the parties to this suit are residents of Illinois, the basis of federal jurisdiction was an alleged diversity of citizenship resulting from the fact that the bankrupt (whose citizenship is taken by the plaintiff as bankruptcy trustee) had moved from Illinois to Michigan between the time of his original bankruptcy in 1936 and the reopening in 1946 (R. 11, 213, 217).

The bankrupt, who is primarily affected, was not made a party to this proceeding. Had he been made a party there could have been no diversity of citizenship.[2]

The District Court after holding that it had jurisdiction by virtue of diversity of citizenship, entered an order of dismissal which provided (R. 203):

> " 'That under the undisputed facts as disclosed by the pleadings, the interests of George R. Joslyn in the Joslyn Family Trusts and the income therefrom in the hands of and under the control of the Joslyn Trustees fall clearly within the protection of Section 49 of the Illinois Chancery Act (Sec. 49 of Ch:22 Ill. Rev. Stats. 1947) and may not be reached by creditors nor a bankruptcy trustee acting in their behalf and that this question of law is free from doubt, and
>
> " 'That said interests of said George R. Joslyn in said trust estates are not property within the meaning of Section 70 of the Bankruptcy Act.' "

The United States Court of Appeals for the Seventh Circuit affirmed the District Court's decision that it had jurisdiction on the ground of diversity of citizenship, but reversed the decree of the District Court on the ground

2. Under Section 23(b) of the Bankruptcy Act (11 U. S. C. 46(b)) the bankruptcy trustee assumes the citizenship of the bankrupt and parties on both sides would have been deemed citizens of the same state.

that under its interpretation of the Illinois statutes and decisions the bankrupt beneficiary had the right to alienate his interest in the Joslyn Family Trusts and that therefore the interests of George R. Joslyn in those trusts could be recovered in a plenary suit against petitioners by virtue of Section 70(a)(5) of the Bankruptcy Act (11 U. S. C. 110(a)(5)) (R. 233-249). The Court of Appeals further held that a federal court in a diversity case is not bound by a state statute or court decisions as to what constitutes property in that state when a plenary suit is brought by a bankruptcy trustee (R. 247-248).

This was on the theory that a holding that would deny relief to the respondent would be in direct conflict with the bankruptcy provisions which Congress in the exercise of its paramount powers had enacted.

The Court of Appeals accordingly remanded the case to the District Court with directions to proceed in accordance with the conclusion reached by the Court of Appeals as set forth in its opinion. Thus, the judgment of the Court of Appeals was a final decision upon a question fundamental to the further conduct of this case. *Land* v. *Dollar,* 330 U. S. 731, 734; *Larson* v. *Domestic & Foreign Corp.,* 337 U. S. 682, 685. Furthermore, the Court of Appeals repeated several times in its opinion that it was ruling upon "the merits" of this case (R. 237-238).

Section 49 of the Illinois Chancery Act[3] has been inter-

3. "Whenever an execution shall have been issued against the property of a defendant, on a judgment at law or in equity, and shall have been returned unsatisfied, in whole or in part, the party suing out such execution may file a complaint against such defendant, and any other person, to compel the discovery of any property or thing in action, belonging to the defendant, and of any property, money or thing in action due to him, or held in trust for him, and to prevent the transfer of any such property, money or thing in action, or the payment or delivery thereof to the defendant, except when such trust has, in good faith, been created by, or the fund so held in trust has proceeded from, some person other than the defendant himself. The court

preted by the Illinois Supreme Court and by this Court to bar every type of action by creditors and by bankruptcy trustees against the interest of a debtor beneficiary or bankrupt beneficiary in trust property "when such trust has, in good faith, been created by" some third person. Such a trust is involved here.

The Joslyn Family Trusts were created in August 1935 by Marcellus L. Joslyn and his wife for the benefit of their four children (including George R. Joslyn, who subsequently in February 1936 became the bankrupt) and their grandchildren (R. 67-87).[4] This was more than three years after the accrual of a stockholders' double liability resulting from the closing of Chicago Bank of Commerce of which the bankrupt was a stockholder (R. 93) and which liability was re-asserted in 1946 in connection with a reopening of the bankruptcy case. George R. Joslyn, the bankrupt, had filed his bankruptcy petition and had received his discharge in 1936 (R. 3).

In reversing the District Court's holding that the interest of George R. Joslyn in the Joslyn Family Trusts was not property which could be recovered in a diversity action by the respondent as bankruptcy trustee, the Court of Appeals refused to follow the decision of the Illinois Supreme Court in *Hummel* v. *Cardwell*, 390 Ill. 526, cert. den. 327 U. S. 793, rhrng. den. 327 U. S. 819, (which the

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shall have power to compel such discovery, and to prevent such transfer, payment or delivery, and to decree satisfaction of the sum remaining due on such judgments, out of any personal property, money or things in action, belonging to the defendant, or held in trust for him, with the exception above stated, which shall be discovered by the proceedings in chancery, whether the same were originally liable to be taken in execution at law or not: • • •." (underlining added.) Sec. 49 of Ch. 22 Ill. Rev. Stats.

4. The respondent and the Court of Appeals refer to the bankrupt's interest in the Joslyn Family Trusts as "vested" equitable life estates. This description is misleading. The bankrupt had no interest in the trust corpus but had solely a right to receive the net income which the Joslyn Trustees were directed to "pay over" to him and the other beneficiaries (R. 69, 79).

District Court had followed) and which had held that a similar interest in a trust was not property which could be recovered in a plenary action by a bankruptcy trustee on behalf of creditors and that such an action was barred by Section 49 of the Illinois Chancery Act.

BASIS FOR JURISDICTION OF THIS COURT.

This Court's jurisdiction is invoked pursuant to Title 28, United States Code, Section 1254(1).

THE QUESTIONS PRESENTED.

I.

Whether in a diversity action the federal court may refuse to follow local property law where the plaintiff sues as trustee in bankruptcy.

II.

a. Whether the doctrine of *Erie* v. *Tompkins*, 304 U. S. 64, applies to a plenary action by a bankruptcy trustee against third parties where local property rights are involved.

b. Whether Section 70(a)(5) of the Bankruptcy Act relating to a bankruptcy trustee's title to property supersedes local rules of property where a bankruptcy trustee seeks to recover in a plenary action in a Federal District Court and where federal jurisdiction is grounded solely on diversity of citizenship.

III.

Whether a state statute which has the effect of closing the doors of the state courts in every form of state court

action by creditors or bankruptcy trustees proceeding against a debtor's interest in a trust nevertheless leaves open the doors of the federal court to such an action where federal jurisdiction is grounded solely upon diversity of citizenship.

IV.

Whether the Court of Appeals instead of deciding a question of Illinois property law contrary to the Illinois statute and decisions should not have remanded this case to the District Court with directions to the respondent to file an appropriate action in the state courts.

REASONS FOR ALLOWANCE OF WRIT.

I.

In this case brought in the federal court on the sole ground of an alleged diversity of citizenship the Court of Appeals decided a question of Illinois property law in direct conflict with the decision of *Hummel* v. *Cardwell,* 390 Ill. 526, in which this Court denied certiorari in 327 U. S. 793, and denied a rehearing in 327 U. S. 819, and also in conflict with the decision of this Court in *Spindle* v. *Shreve,* 111 U. S. 542 (involving the identical Illinois statute).

II.

In this diversity case, where the plaintiff brought a plenary action as trustee in bankruptcy, the Court of Appeals in holding that federal law was paramount to the Illinois property law, decided a federal question in conflict with the applicable decisions of this Court in *Erie* v. *Tompkins,* 304 U. S. 64; *Angel* v. *Bullington,* 330 U. S. 183, 191, and *Guaranty Trust Co.* v. *York,* 326 U. S. 99, 109.

III.

In deciding that creditors and a bankruptcy trustee may be barred from relief when a plenary suit is brought in the state courts but that a federal court in a diversity suit may grant relief which the state courts would have denied, the Court of Appeals decided a federal question in direct conflict with the decision of this Court in *Woods* v. *Interstate Realty Co.*, 337 U. S. 535.

IV.

In refusing to follow the case of *Hummel* v. *Cardwell*, 390 Ill. 526, on the ground that the relevant portion of the decision constituted *dictum* or that the Illinois property law was not settled, the Court of Appeals should have remanded this case to the District Court with directions to provide appropriate submission to the state court of the question here involved. In failing to so remand this case, the Court of Appeals decided an important federal question in direct conflict with the policy established by this Court in *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, *Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168, and *Mangus* v. *Miller*, 317 U. S. 178.

Respectfully submitted,

BENTLY S. HANDWORK, RALPH C. BOOZER, and PHILIP W. LOTZ, Individually and as Trustees, etc,

By HOMER D. DINES,
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Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The District Court did not prepare or publish a formal opinion.[5] The opinion of the Court of Appeals has been published at 179 F. 2d 70 (adv. sh.) and appears in the transcript of the record at pages 233 to 249.

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5. Another Judge of the District Court rendered an opinion published at 85 F. Supp. 68, in the related case of *Young* v. *First Nat. Bank of Chicago,* involving the same plaintiff who is respondent here and the same interest in the Joslyn Family Trusts. The District Court there reached an opposite result to that of the Court of Appeals here. This Court is respectfully referred to that opinion.

JURISDICTION.

This Court's jurisdiction is invoked pursuant to Title 28, United States Code, Section 1254(1).

STATEMENT OF THE CASE.

A concise statement of the case containing all that is material to the consideration of the questions presented, with appropriate page references to the printed record, is set forth on pages 2 to 6 of the Petition for Writ of Certiorari, and for brevity is not here repeated.

SPECIFICATION OF ERRORS.

The Court of Appeals erred in deciding in a diversity case a question of Illinois property law in direct conflict with the decision of the Illinois Supreme Court in *Hummel* v. *Cardwell,* 390 Ill. 526, cert. den. 327 U. S. 793, rhrng. den. 327 U. S. 819, and in direct conflict with the decision of this Court in *Spindle* v. *Shreve,* 111 U. S. 542 (involving the identical Illinois statute).

The Court of Appeals further erred in deciding in a diversity case where the plaintiff sues as trustee in bankruptcy on behalf of creditors that the court may refuse to be bound by the Illinois property law as embodied in the Illinois statutes and decisions.

The Court of Appeals further erred in deciding that creditors and a bankruptcy trustee suing on behalf of creditors may be barred from relief in the state courts,

but that the federal court in a diversity case may grant relief which the state courts would have denied.

The Court of Appeals further erred in failing to remand this cause to the District Court with directions to submit the questions of Illinois property law to the state courts for a determination instead of interpreting Illinois property law independently of and in conflict with the decisions of the Illinois Supreme Court.

ARGUMENT.

I.

By Interpreting Section 49 of the Illinois Chancery Act (Sec. 49 of Ch. 22, Ill. Rev. Stats.) in Direct Conflict With the Decision of Hummel v. Cardwell, 390 Ill. 526, Cert. Den. 327 U. S. 793, the Court of Appeals in a Diversity Case Decided a Question of Illinois Property Law Contrary to the Illinois Statutes and Decisions.

In holding that the respondent was entitled to recover against the petitioners, the Court of Appeals established a rule for the federal courts in a diversity case in direct conflict with the decision of the Illinois Supreme Court in *Hummel* v. *Cardwell*, 390 Ill. 526, in which this Court denied certiorari in 327 U. S. 793 and a rehearing in 327 U. S. 819. In the *Hummel* v. *Cardwell* case, it was held that a bankruptcy trustee could not recover trust funds in the hands of an active trustee because Section 49 of the Illinois Chancery Act constituted a rule of property and not of procedure only.

The facts in this case and in the *Hummel* v. *Cardwell* case are substantially identical. In both cases the trusts involved were created by someone other than the debtors.

In both cases a trustee in bankruptcy sought to recover in a plenary suit against the trustees holding the trust funds. In both cases Section 49 of the Illinois Chancery Act was set up as a defense and in both cases it was recognized that creditors could not recover such trust interests by any remedy available under Illinois law. The principal difference was this: In the *Hummel* v. *Cardwell* case it was held that a bankruptcy trustee could not recover such trust interests in the state courts. In this case the Court of Appeals held that in a diversity case the federal courts would allow a recovery.

As has been shown, Section 49 provides immunity against creditors' claims where the debtor's property is held in trust and "when such trust has, in good faith, been created by, or the fund so held in trust has proceeded from some person other than the defendant himself" (Sec. 49 of Ch. 22, Ill. Rev. Stats.—set forth in footnote 3, *supra*, p. 4).

Both the Illinois Supreme Court and this Court have held that Section 49 constitutes "a rule of property and not of procedure only." *Potter* v. *Couch*, 141 U. S. 296, also *Hummel* v. *Cardwell*, 390 Ill. 526, cert. den. 327 U. S. 793, rhrng. den. 327 U. S. 819. In other words, the procedure or remedy adopted by a creditor or a bankruptcy trustee, as the representative of creditors, is immaterial. Such trust interests simply cannot be reached by or on behalf of creditors. This was the uniform holding of the Illinois courts and federal courts in diversity cases prior to the opinion of the Court of Appeals in this case.

In *Potter* v. *Couch*, 141 U. S. 296, and in *Binns* v. *LaForge*, 191 Ill. 598, it was held by the Supreme Court of the United States and by the Supreme Court of Illinois, respectively, that a creditor's bill would not lie against such trust interests in view of the statute. The same bar applies with respect to the remedies of garnishment, *Baum-*

garden v. *R. C. F.*, 131 F. (2d) 741 (C. C. A. 7), and attachment, *Dunham* v. *Kauffman*, 385 Ill. 79.

It is also specifically held, that in view of Section 49 of the Illinois Chancery Act, such trust interests may not be reached by an assignee or trustee in bankruptcy (the exact question involved here). *Spindle* v. *Shreve*, 111 U. S. 542, *Hummel* v. *Cardwell*, 390 Ill. 526, cert. den. 327 U. S. 793, rhrng. den. 327 U. S. 819.

In *Hummel* v. *Cardwell*, 390 Ill. 526, the Illinois Supreme Court answered every argument which the respondent has been able to advance. The Court in holding against the bankruptcy trustee there, said (p. 534):

> "If the protection of Section 49 of the Chancery Act makes the interest * * * in the trust immune from any suit or lien by a creditor, surely a trustee in bankruptcy representing a creditor can have no greater or superior right. In the matter of exemptions and the interpretations of property rights, the bankruptcy courts have always regarded decisions of the State courts as controlling. (*Erie* v. *Tompkins*, 304 U. S. 64.)"

When confronted with the argument that the trust interest should be taken despite its immunity from suits or liens in the state courts, the Illinois Supreme Court said (pp. 534-535):

> "The trustee in bankruptcy contends that the amendment to the Bankruptcy Act in 1938 shows that property, even though it may not be subject to seizure, may pass to the trustee if it is transferable. With the exception given to exempt property in section 70A of the act and the power to acquire property through a plenary suit limited to those of a judgment creditor in section 70C, we do not construe the act to give a trustee in bankruptcy in plenary suits greater remedies in a State suit than those afforded a judgment creditor. Any other rule would be contrary to the plain language of section 70C and permit a trustee

to take property which, under the laws of Illinois, could not be taken by any other plaintiff for the payment of a debt. In *Dunham* v. *Kauffman*, 385 Ill. 79, we held that the interest of a beneficiary in a trust could not be reached by attachment. In *Baumgarden* v. *Reconstruction Finance Corp.*, 131 Fed. 2d 741, the Circuit Court of Appeals held that a trust fund which came squarely under the exception in section 49 of the Chancery Act could not be reached by garnishment.

The Illinois Supreme Court concluded upon this point as follows (p. 535):

> "It is clear, from the holdings of this court and that of other jurisdictions, that section 49 of the Chancery Act creates a rule of property and does not relate solely to procedure. (*Potter* v. *Couch*, 141 U. S. 296.)" (Underlining added.)

The Court of Appeals sought to avoid the clear language of the *Hummel* case by referring to the cross-appeal of the trust beneficiary in that case (who had failed to raise the defense of Section 49 in previous litigation, and in consideration of a satisfaction of a large indebtedness, had agreed to not appeal from the decree rendered there). In connection with that other appeal, the Illinois Supreme Court stated that the beneficiary was "estopped from litigating those questions again". That is the holding which the Court of Appeals described as a "voluntary conveyance" (R. 245). But that part of the *Hummel* case could not be interpreted as authorizing a transfer or sale by a beneficiary of trust interests in a trust created for his benefit and any such attempted interpretation runs into direct conflict with the plain language of the *Hummel* case upon the precise point involved here, *i.e.*, that a bankruptcy trustee is not entitled under Illinois law to recover trust funds of a section 49 trust in the hands of trustees where the trust beneficiary has become a bankrupt.

Nor is there any basis in any of the other Illinois decisions for the Court of Appeals to decide that interests of a beneficiary in such a trust may be freely and voluntarily transferred by the life beneficiary so as to subject the same to seizure in a plenary suit brought by a bankruptcy trustee. On the contrary, it was flatly held in *Hopkinson* v. *Swaim*, 284 Ill. 11, that trust income could not be voluntarily transferred by the life beneficiary, even though the will contained no express language against alienation. The Court there added:

> "There could be no such exemption from liability for debt if the beneficiary could convey or assign the income, for if she could do so it could also be seized in execution or attachment or reached by a creditor's bill."

In *Spindle* v. *Shreve*, 111 U. S. 542, this Court in referring specifically to Section 49 held that an assignee in bankruptcy could recover no interest in a trust falling within the protection of the Illinois Statute. This Court stated (pp. 547-548):

> "The statute of Illinois does not apply merely, as is argued, to cases where a technical discovery is sought, but to all cases where the creditor, or his representative, is obliged, by the nature of the interest sought to be applied, to resort to a court of equity for relief, as he must do, in all cases where the legal title is in trustees, * * *.
>
> "It cannot be doubted, that it is competent for testators and grantors, by will or deed, to construct and establish trusts, both of real and personal property, and of the rents, issues, profits and produce of the same, by appropriate limitations and powers to trustees, which shall secure the application of such bounty to the personal and family uses during the life of the beneficiary, so that it shall not be subject to alienation, either by voluntary act on his part, or *in invitum*, by his creditors. The limits, within which

such provisions may be made and administered, of course, must be found in the law of that jurisdiction which is the *situs* of the property, in case of real estate, and in cases of personalty, where the trust was created or is to be administered according to circumstances. * * *

"* * * applied to the circumstances of the present case, the question would be merely, whether, according to the law of Illinois, the terms of the trust, * * *, created an interest or estate in the beneficiary, which, * * *, could be taken at law or in equity for payment of his debts, and which, therefore, vested in his assignee in bankruptcy.

"* * *, by reason of the positive provisions of the statute of Illinois, to which we have referred, the appellant (assignee in bankruptcy) has shown no right to the relief for which, in his bill, he prayed" (Matter in parentheses and underlining added).

Although the sole basis for the decision in *Spindle* v. *Shreve,* 111 U. S. 542, was that Section 49 of the Illinois Chancery Act accorded immunity in a plenary suit by a bankruptcy trustee, the Court of Appeals appeared to be of the erroneous opinion that the Court in that case based its holding upon certain language in the trust instrument involved there which is commonly found in some so-called "spendthrift trusts".

It should be noted, however, that whether the trust in this case is of the type commonly referred to as a "spendthrift trust" or merely an active trust falling within the protection of Section 49, the ruling should have been the same. Referring to the Illinois statute, the author of the note in 119 A. L. R. 41 states:

"* * * the effect of the statute appears to be to make all trusts, except those for the benefit of the settlor, spendthrift trusts as against creditors of the beneficiary."

In *Knight* v. *Gregory,* 389 Ill. 554, at page 561 it was stated that:

> "In view of section 49 of the Chancery Act, however, all active trusts, which otherwise qualify, come under the doctrine of *Steib* v. *Whitehead*" (A leading spendthrift trust case in Illinois).

In other words, the rule in Illinois is definitely and firmly established that the same immunity is accorded to trust interests falling within the provisions of Section 49 of the Illinois Chancery Act, as is granted to so-called spendthrift trusts.

The Court of Appeals was also of the erroneous opinion that the *Spindle* case was not binding upon it because it was decided under an earlier Bankruptcy Act which, it is stated, did not affect transferable property.

As appears clearly from the decision itself, the assignee in bankruptcy received a transfer of all of the property of the bankrupt "not exempt from execution". As it has never been contended that Section 49 is an exemption statute, this would not exclude property falling within the protection of its provisions if such property were administerable. Further refutation of the Court of Appeals' view is contained in *Durant* v. *Hospital Life Insurance Co.*, Federal Cases No. 4188, where in construing the Bankruptcy Act of 1869 it was stated "* * * the assignee under our bankrupt law takes at once whatever interest is assignable, * * *."

The attempted distinction by the Court of Appeals of the *Hummel* and *Spindle* cases is untenable on two further grounds. First: The Illinois cases referred to by the Court of Appeals do not hold that a beneficiary of a Section 49 trust may freely assign or sell his right to receive future income. Instead, those cases involve an application of the doctrine of estoppel where transfers have been made in violation of authority (R. 240). Second: Even if capable of transfer under certain circumstances, the Court of Appeals should have followed the state de-

cisions holding that trust interests under Section 49 do not constitute transferable or leviable property which a bankruptcy trustee may recover under the Illinois statute and decisions.

A very similar situation under the 1898 Bankruptcy Act (the same bankruptcy act involved here) was ruled upon by this Court in *Eaton* v. *Boston Trust Co.*, 240 U. S. 427, where it was held that even though a trust interest was assignable under certain circumstances under the Massachusetts law, such an interest did not pass to a trustee in bankruptcy, if it could not have been reached under the state decisions by creditors or a bankruptcy trustee. In that case, Justice Holmes speaking for this Court declared (pp. 428-429):

> "It is established law in Massachusetts that such trusts are valid and effective against creditors, *Broadway National Bank* v. *Adams*, 133 Massachusetts 170, and, subject to what we are about to say, against assignees in insolvency or trustees in bankruptcy. *Billings* v. *Marsh*, 153 Massachusetts 311. *Munroe* v. *Dewey*, 176 Massachusetts 184. The trustee in bankruptcy seeks to avoid the effect of these decisions on the ground that Mrs. Luke's equitable life interest was held by the Supreme Court of the State to be assignable, and that therefore it passed under Sec. 70a(5) of the Bankruptcy Act, vesting in the trustee all property that the bankrupt 'could by any means have transferred.' The Supreme Judicial Court, however, held that the above cited cases governed and that the property did not pass. 220 Massachusetts 484.
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> "The law of Massachusetts treats such restrictions as limiting the character of the equitable property and inherent in it. *Dunn* v. *Dobson*, 198 Massachusetts 142, 146. *Lathrop* v. *Merrill*, 207 Massachusetts 6, 9. Whatever may have been the criticisms upon the policy and soundness of the doctrine, and whatever may be the power of this court to weigh the reasoning upon

which it has been established by the Massachusetts cases, *Page* v. *Edmunds,* 187 U. S. 596, 602, it has been established too long and is too nearly sanctioned by the decisions of this court to be overthrown here. *Nichols* v. *Eaton,* 91 U. S. 716. *Shelton* v. *King,* 229 U. S. 90. The policy of the Bankruptcy Act is to respect state exemptions, and until the Massachusetts decisions shall have gone farther than they yet have we are not prepared to say that the present bequest is not protected by the Massachusetts rule."

The situation under the Illinois Statute (Section 49) is precisely the same as under the Massachusetts decisions, *i.e.,* the interest in the trusts may not be reached by creditors or a bankruptcy trustee who sues in their behalf.

Justice Holmes, in referring to a supposititious case, observed that where a beneficiary had the power to free the corpus as well as the income from the trust restrictions the argument would be very strong that the statute (that is, the Bankruptcy Act) intended the fund to pass. He also observed (p. 428) that "there would be difficulty in admitting that a person could have property over which he could exercise all the powers of ownership except to make it liable for his debts."

The rule applied in deciding the issues in the *Eaton* v. *Boston Trust* case is the rule which should be applied here. Respondent in his brief may urge this Court to follow the *dictum* referred to by Justice Holmes in the supposititious case. We again call this Court's attention to the fact that George Joslyn could not by any act on his part free the corpus of either of the Joslyn Family Trusts from the terms of the trust instruments. Nor does George Joslyn exercise any powers of ownership over the trust estates. He is purely and simply a life beneficiary in the income from the Joslyn Family Trusts as was the beneficiary involved in *Eaton* v. *Boston Trust.*

If the opinion of the Court of Appeals is permitted to stand the effect will be to provide a new remedy not heretofore available under Illinois law which may be employed only in the unique cases where a bankruptcy trustee may invoke federal jurisdiction on the ground of diversity of citizenship in an action to subject trust interests.

If allowed to stand, we shall have two bodies of property law in Illinois, one applicable in actions decided by the State courts and another in diversity actions in the federal courts, as it is not to be anticipated that the Illinois Supreme Court will agree to have its holdings on Illinois property law overruled by the Court of Appeals for the Seventh Circuit, which is supposed to apply Illinois property law as embodied in the Illinois statutes and decisions.

If the Court of Appeals in this case is right and the Illinois Supreme Court in the *Hummel* v. *Cardwell* case is wrong, this Court should have allowed Hummel's petition for certiorari. (See *Hummel* v. *Cardwell,* Nos. 823-825, October Term, 1945, cert. den. 327 U. S. 793.) It was argued by the petitioner there that the Illinois Supreme Court had denied relief to which *Hummel* as trustee in bankruptcy was entitled by the Bankruptcy Act. It was further argued there that the Illinois Supreme Court had decided a federal question erroneously when it held that *Hummel* as bankruptcy trustee could not recover in the State courts, in view of Section 49 of the Illinois Chancery Act.

The denial by this Court of certiorari in *Hummel* v. *Cardwell,* 327 U. S. 793, appeared to put at rest the contention that a bankruptcy trustee was entitled to employ additional remedies and obtain relief not available to creditors in the State courts of Illinois.

But the Court of Appeals has granted to the bankruptcy trustee in this case (which would have been tried in the

state courts except for the alleged diversity) a new remedy and relief never granted heretofore to any creditor or bankruptcy trustee.

Hereafter, if garnishment, attachment and creditors' bills fail, the creditor need only file a petition in bankruptcy against the debtor, and the trust intended for the support of the debtor and his family may be seized by the bankruptcy trustee and sold.

If the Court of Appeal's decision is permitted to stand, it may well follow that the remedies, heretofore denied by the Illinois courts, will be available to all creditors as well as to bankruptcy trustees in the federal courts sitting in Illinois. For, if the income of beneficiaries under Section 49 trusts is freely transferable, then, as stated in *Hopkinson* v. *Swain,* 284 Ill. 11, 23, "it could also be seized in execution or attachment or reached by a creditor's bill".

Thus, unless certiorari is granted and the judgment in this case reversed, the ruling of the Court of Appeals will have dire effects upon the Illinois law of trusts and the property rights of settlors and beneficiaries alike.

II.

In This Diversity Case the Court of Appeals Was Bound by the Doctrine of Erie v. Tompkins, 304 U. S. 64, Notwithstanding the Fact That the Plaintiff Was a Trustee in Bankruptcy.

The sole ground for alleged federal jurisdiction in this case is diversity of citizenship. In the absence of an alleged diversity, this action could only have been brought in a state court (11 U. S. C. 46b) and in view of the decision in *Hummel* v. *Cardwell,* 390 Ill. 526, cert. den. 327 U. S. 793, rhrng. den. 327 U. S. 819, there can be no doubt that

in any such state court action the substantive Illinois law and policy would have precluded the respondent from any recovery against the petitioners.

The Court of Appeals was of the opinion that this was a different type of diversity case because the respondent asserted his right to the trust interests under Section 70(a)(5) of the Bankruptcy Act (11 U. S. C. 110(a)(5)),[6] (R. 247). It concluded that it was not bound by *Erie* v. *Tompkins,* 304 U. S. 64 (which established the rule that federal courts in diversity cases should apply the substantive law of the state).

Even prior to *Erie* v. *Tompkins,* 304 U. S. 64, the federal courts in diversity actions brought by trustees in bankruptcy generally followed the state decisions with respect to what constitutes property. This doctrine has been fortified since *Erie* v. *Tompkins,* and has been clarified in a number of later decisions.

In *Guaranty Trust Co.* v. *York,* 326 U. S. 99 (1945), after referring to *Erie* v. *Tompkins,* the court declared (p. 109) that the essence of that decision was to insure that "• • • in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court."

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6. Although claiming title under Section 70(a), the filing of a plenary action by the respondent also required the assertion of rights under Section 70(c) which prescribes the remedies of a bankruptcy trustee. Respecting the remedies where property sought to be recovered is, as here, *not* in the possession of the bankrupt, Section 70(c) provides: "The trustee shall be deemed vested as of the date of bankruptcy with all of the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists" (11 U. S. C. 110(c)). As appears from the discussion under Point I no remedy available to the respondent would entitle him to make a recovery here.

Angel v. *Bullington*, 330 U. S. 183 (1947), also made clear that state law and state policy would be enforced by the federal courts where jurisdiction was based solely upon diversity of citizenship. This Court there said at page 187:

> "For purposes of diversity jurisdiction a federal court is, 'in effect, only another court of the State'."

This Court added at pages 191-192:

> "The essence of diversity jurisdiction is that a federal court enforces State law and State policy. • • • North Carolina would hardly allow defeat of a State-wide policy through occasional suits in a federal court. What is more important, diversity jurisdiction must follow State law and policy. A federal court in North Carolina, when invoked on grounds of diversity of citizenship, cannot give that which North Carolina has withheld. Availability of diversity jurisdiction which was put into the Constitution so as to prevent discrimination against outsiders is not to effect discrimination against the great body of local citizens."

The Court of Appeals in declining to adhere to this rule based its action primarily on *Marine Harbor Properties Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78, a Chapter X proceeding, in which the federal bankruptcy court declined to interfere with a pending state court foreclosure proceeding although recognizing its superior right where a debtor has in good faith sought relief under the Federal Bankruptcy laws. That case is wholly irrelevant here.

The question here is whether the bankrupt's right to receive income from a section 49 trust estate is *property* (under Illinois law) which may be recovered by a bankruptcy trustee in a plenary action. The result should not be different merely because the action is brought in the federal court on the ground of a diversity of citizenship. It is stated in Collier on Bankruptcy, (14th Ed.) Vol. 4, page 1149, as follows:

> "Whether the bankrupt's interest as a *cestui que trust* was, at the time of the bankruptcy, assignable or transferable, or subject to attachment, seizure or judicial sale, are matters generally to be determined by the law of the state where the trust has its situs."

The respondent's action is not a proceeding brought under the bankruptcy act, but a plenary action brought in the federal court by the plaintiff, as bankruptcy trustee solely on the grounds of diversity of citizenship.

The question is not—shall the bankruptcy act or section 49 prevail?

Here, the sole question is whether, in a diversity case, a federal court will grant relief which could not be obtained in the state courts.

In declining to adhere to the doctrine of *Erie* v. *Tompkins*, the Court of Appeals also relied upon the case of *In re Landis*, 41 F. 2d 700, which was decided in 1932, or more than six years prior to *Erie* v. *Tompkins*. In the *Landis* case, the same Court of Appeals refused to be bound by the Illinois decisions as to whether a contingent remainder constituted property administerable in bankruptcy (R. 247-248). Yet in the face of that decision which held that contingent interests are transferable, the Illinois courts have continued to hold that such contingent interests are not transferable and may not be taken by a bankruptcy trustee. *Johnston* v. *Herrin*, 383 Ill. 598. Hence, it is not to be expected that the Illinois Supreme Court will agree with the independent and conflicting interpretation of Illinois property law made in this case by the same Court of Appeals. This is especially true in view of the unequivocal position taken by the Illinois Supreme Court in the *Hummel* case which, as has been shown, this Court declined to review on a petition for certiorari, 327 U. S. 793.

This Court has never held and should not now give its

acquiescence to the holding of the Court of Appeals that in a diversity action brought by a bankruptcy trustee involving local property law, the federal court may refuse to follow the substantive law of the State. If allowed to stand, the opinion of the Court of Appeals will breed conflict between the Federal and State Courts where there has been harmony heretofore.

III.

The Illinois Statute and Decisions Having Barred Creditors and Bankruptcy Trustees From Any Remedy, the Federal Courts Should Not Provide a Remedy Where Federal Jurisdiction Is Grounded Solely on a Diversity of Citizenship.

As we have pointed out (*supra,* pp. 12-13) under Illinois law creditors and bankruptcy trustees are barred from employing the remedies of attachment, creditor's bill, and garnishment in actions against trustees of an active trust created by some person other than the debtor. As interpreted by the Illinois decisions, Section 49 of the Illinois Chancery Act is equivalent to the statute found in *Woods* v. *Interstate Realty Co.,* 337 U. S. 535, which provided that corporations not qualified to do business within the State of Mississippi "shall not be permitted to bring or maintain any suit in any of the courts in this State." Similarly, creditors and bankruptcy trustees representing creditors are barred in the Illinois courts from bringing or maintaining any action to recover any interest in a trust where the trust interest falls within the protection of Section 49 of the Illinois Chancery Act.

The rule in *Woods* v. *Interstate Realty Co.,* 337 U. S. 535, is clearly applicable in providing (p. 538) "that where in such cases one is barred from recovery in the state court, he should likewise be barred in the federal court."

IV.

The Court of Appeals Should Have Remanded This Case For Submission of the Questions of Illinois Property Law to the State Courts Where it Refused to Recognize the Finality of Hummel v. Cardwell.

If the Court of Appeals doubted the finality of *Hummel* v. *Cardwell,* it should have remanded this cause to the District Court with directions to have the question of Illinois property law submitted to the state courts for a determination. The Court of Appeals in its opinion endeavored to minimize the controlling effect of *Hummel* v. *Cardwell* by referring to the clear language of that case (in so far as the respondent's claim is concerned) as *dictum* (R. 245). It is clear that where questions of local law are involved, the expressions of the highest state court—even though *dictum*—should be followed by the federal courts. *Hawks* v. *Hamill,* 288 U. S. 52, 53 S. Ct. 240, 77 L. Ed. 610; *Yoder* v. *Nu-Enamel Corporation,* 117 F. 2d 488, 489 (C. C. A. 8), and 35 C. J. S. pp. 1259-1260.

Even assuming, for purposes of argument only, that the Court of Appeals was correct in characterizing the relevant part of the decision in *Hummel* v. *Cardwell* as *dictum,* still its independent interpretation of Illinois property law was in direct conflict with the doctrine and policy established by this Court in *Thompson* v. *Magnolia Co.,* 309 U. S. 478, 481; *Chicago* v. *Fieldcrest Dairies,* 316 U. S. 168, and in *Mangus* v. *Miller,* 317 U. S. 178 (a farmer-debtor proceeding).

In each of those cases this Court held that where a matter of local property law was unsettled, the federal court should direct a submission of the state property questions to the state courts for decision. In each of those

cases this Court remanded the causes with directions for the filing of a proper state court proceeding.

There can be no question but that had the same issue of Illinois property law been presented to an Illinois state court, the result would have been exactly opposite to that reached by the Court of Appeals.

In this case, a question of Illinois property law is of primary importance, but it was contended by the respondent (and erroneously held by the Court of Appeals) that a question of federal bankruptcy law was paramount.

In *Chicago* v. *Fieldcrest Dairies,* 316 U. S. 168, 171, it was similarly argued by the respondent there that a question of federal constitutional law required interpretation by the federal courts. But this Court, after granting certiorari, held that first there were important questions of Illinois law to be decided. The parties were, therefore, remitted to the state courts for litigation of the state questions involved in the case.

In this connection, if, as we have shown, it is the law of Illinois that the interest of the beneficiary in the Joslyn Family Trusts is not property that may be freely and voluntarily transferred by the beneficiary, then there is obviously no property here upon which the federal bankruptcy act may operate.

Furthermore, if, as we have further shown, it is the law of Illinois that neither a creditor nor a bankruptcy trustee has any remedy against such a trust interest in the state courts, then it also follows that in this diversity case the respondent has no remedy and the bankruptcy act does not become involved.

As appropriately stated in the *Chicago* v. *Fieldcrest* case (p. 173) (in referring to the federal constitutional question): "that issue may not survive the litigation in the state courts. If it does not, the litigation is at an end.

That again indicates the wisdom of allowing the local law issues first to be resolved by those who have the final say."

In order that there may not be two separate doctrines—one applicable in the Illinois courts and another applicable in the federal courts sitting in Illinois in diversity actions, (if this Court should decide that the question of Illinois property law here involved has not been settled), this Court should allow certiorari in order to remand this cause to the District Court with directions to have the questions of Illinois Property law submitted to the state court for a decision as was done in *Thompson* v. *Magnolia Co., Chicago* v. *Fieldcrest Dairies* and *Magnus* v. *Miller.* This would enable the Illinois court to clarify its holding in *Hummel* v. *Cardwell,* if such is necessary, or to itself reverse the ruling there made if that Court feels that its decision there was wrong.

Conclusion.

The effect of the opinion of the Court of Appeals was to overrule the decision of the Illinois Supreme Court in *Hummel* v. *Cardwell,* 390 Ill. 526, cert. den. 327 U. S. 793. Unless the doubt and confusion resulting from the Court of Appeal's opinion is resolved by this court by granting this petition and reversing the judgment of the Court of Appeals there will be two bodies of property law in Illinois affecting every Illinois trust except those created by the beneficiary himself. It is to be anticipated that the opinion of the Court of Appeals would be employed as a basis for overruling the long line of decisions by which creditors and bankruptcy trustees have been barred in every type of action against trust interests such as are here involved. In order that there may be uniformity in the state courts and in Federal courts in diversity actions,

this court should grant to the petitioners a writ of certiorari to review the decision of the Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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